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### Development and Status of Insurance Bad Faith in Montana

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# INSURANCE CONSUMER COUNSEL'S COLUMN

## DEVELOPMENT AND STATUS OF INSURANCE BAD FAITH IN MONTANA

BY PROFESSOR GREG MUNRO

Since most of our torts had their inception hundreds of years ago in England, the cause of action known as bad faith is a new development. Nevertheless, in its short history in Montana, it has already been the subject of an intense tug of war between those who view it as a necessary tool

for balancing the disparity of power between consumers and corporations and those who view it as an intolerable pox on

corporate profits. Insurance bad faith and its attendant threat of punitive damages are the most viable and effective tools plaintiff's counsel has at his or her disposal for enforcing duties and promises of insurance companies. In Montana, the courts originally created insurance bad faith tort and, when necessary, based it on violations of the state insurance code. Ironically, the legislature's attempts to restrict insurance bad faith in the name of tort "reform" have resulted in codification of a good deal of common law followed by expansive court interpretations of the statute. Hence, the tort is very much alive and evolving in 2000. Within the limits of these pages, I will outline the development of the tort of bad faith as it applies to insurance in Montana ending with particular attention to the issue of the existence now of bad faith tort outside the Unfair Claim Settlement Practices Act<sup>1</sup>. At the outset, I want to thank Pat Sheehy and Gary Zadick for their invaluable review and comment on this work.

### Early History of the Tort

In 1964, Federal Judge Jami-

son delivered the landmark opinion of *Jessen v. O'Daniel*<sup>2</sup> which recognized an insurer's liability to its own insured for failure to accept a reasonable settlement offer on a claim against the insured. The often-cited case received national attention and, to this day, is the seminal word in

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**Insurance bad faith and its attendant threat of punitive damages are the most viable and effective tools plaintiff's counsel has at his or her disposal for enforcing duties and promises of insurance companies.**

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Montana and other states on the duty of the insurer in considering settlement offers. Jamison held that "the insurer must give the interests of its insured equal consideration with its own interests and must in all respects deal fairly with the insured."<sup>3</sup> He set forth the factors the insurer must consider in determining whether to settle for the benefit of its insured:

- (1) whether, by reason of the severity of the plaintiff's injuries, any verdict is likely to be greatly in excess of the policy limits;
- (2) whether the facts in the case indicate that a defendant's verdict on the issue of liability is doubtful;
- (3) whether the company has given due regard to the recommendations of its trial counsel;
- (4) whether the insured has been informed of all settlement demands and offers;
- (5) whether the insured has demanded that the insurer settle within the policy limits;
- (6) whether the company has given due consideration to any offer of contribution made by the insured.<sup>4</sup>

Insofar as it placed on an insurer a liability over and above its contractually promised limit of coverage, *Jessen* was the first "bad faith" case in Montana. It was a "first-party" "excess-coverage" case. *Jessen* was followed by similar first-party excess-coverage cases including *Fet-*

*ter Livestock Co. v. National Farmers Union Property & Casualty Co.*,<sup>5</sup> *Fowler v. State Farm Mut. Auto. Ins. Co.*,<sup>6</sup> and, *Thompson v. State Farm Mut. Auto. Ins.*

*Co.*,<sup>7</sup> which applied the *Jessen* factors while mixing concepts of bad faith and negligence. However, in each case the courts found that the insurer's conduct was not actionable.

In the *Jessen* era, the courts contributed a couple of contract decisions important to the history of bad faith law and punitive damages in Montana. First, in *Westfall v. Motors Ins. Corp.*,<sup>8</sup> the Montana Supreme Court held that one could not obtain punitive damages for a breach of contract even though the breach was willful or fraudulent. However, in *State ex rel. Larson v. District Court of the Eighth Judicial Dist.*,<sup>9</sup> the court, for insurance contracts, made an exception to the *Westfall* rule. The *Larson* court noted that MCA §27-1-202 provides "[e]very person who suffers detriment from the unlawful act or omission of another may recover from the person in fault a compensation therefore in money, which is called damages."<sup>10</sup> Recognizing that a breach of an insurance contract could also be a violation of the Montana Insurance Code such that it would be an unlawful act under §27-1-202, the court held the situation distinguishable from *Westfall*, so that punitive damages would be

available. *Larson* was viewed as judicial creation of a new bad faith cause of action based in statute.<sup>11</sup> If an insurer's breach of contract was also a violation of the Montana Insurance Code, then the defendant insurer was potentially liable under the "unlawful act or omission" provision of §27-1-202. Plaintiffs' attorneys would refer to this form of bad faith as "tortious breach of the insurance code."

One should note here that, in 1959, Montana adopted an insurance code for the protection of its citizens.<sup>12</sup> The 1959 code lacked any comprehensive statement of duties an insurer owed its insured or third-party claimants. It did contain provisions, which, if violated, might provide a cause of action and punitive damages under *Larson*.

In 1982, the Montana Supreme Court decided in *Weber v. Blue Cross of Montana*,<sup>13</sup> that health service corporations like Blue Cross are not subject to the insurance code (and hence, tortious breach of the code), but are nevertheless subject to a duty of good faith and potentially liable for breach of that duty. The court reasoned that the health services corporation's superior bargaining position in relation to its insured, the insureds' lack of voice in negotiating the contracts and the corporation's potential for oppressive tactics in handling claims all made it appropriate that it be subject to a good faith duty.<sup>14</sup>

*Lipinski v. Title Ins. Co.*,<sup>15</sup> made it clear that there existed a common law tort of bad faith that applied to insurance companies. The court said, "[s]hould there be any doubt, we now expressly hold that insurance companies have a duty to act in good faith with their insureds, and that this duty exists independent of

the insurance contract and independent of statute."<sup>16</sup> In *Lipinski*, the court recognized the prima facie tort of insurance bad faith which would support a punitive damages claim.

### Advent of the Unfair Trade Practices Act

Until 1977, the Montana Insurance Code, contained no comprehensive statement of insurer's duties. In 1977, the Montana Legislature added to the Code a set of 14

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**The court's holding virtually eliminated the actual damage requirement and made a claim possible where the insurer's handling of the claim was offensive even though it ultimately did not owe the benefit it denied.**

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"unfair claims settlement practices" which were forbidden by "any person" acting "with such frequency as to indicate a general business practice."<sup>17</sup> These were codified as MCA §33-18-201 and have not been amended since their adoption. Their key prohibitions form the backbone of the present bad faith insurance remedies in Montana:

### 33-18-201 Unfair claim settlement practices prohibited.

No person may, with such frequency as to indicate a general business practice, do any of the following:

- (1) misrepresent pertinent facts or insurance policy provisions relating to coverages at issue;
- (2) fail to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies;
- (3) fail to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies;

(4) refuse to pay claims without conducting a reasonable investigation based upon all available information;

(5) fail to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed;

(6) neglect to attempt in good faith to effectuate prompt, fair, and equitable

settlements of claims in which liability has become reasonably clear;

(7) compel insureds to institute litigation

to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds;

(8) attempt to settle a claim for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application;

(9) attempt to settle claims on the basis of an application that was altered without notice to or knowledge or consent of the insured;

(10) make claims payments to insureds or beneficiaries not accompanied by statements setting forth the coverage under which the payments are being made;

(11) make known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or

compromises less than the amount awarded in arbitration;

(12) delay the investigation or payment of claims by requiring an insured, claimant, or physician of either to submit a preliminary claim report and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information;

(13) fail to promptly settle claims, if liability has become reasonably clear, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage; or

(14) fail to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement.

The statute, which constituted a fairly comprehensive statement of prohibited practices of the insurers in handling claims, would provide the basis for pleading causes of action for tortious breach of the insurance code.

In *First Security Bank of Bozeman v. Goddard*,<sup>18</sup> the court recognized that breach of an insurance contract could "sound in tort al-

though it arises out of a breach of contract, if a defaulting party, by breaching the contract, also breaches a duty which he owes to the other party independently of the contract."<sup>19</sup> Though the court in *Goddard* expressly found the insurer's conduct to be a breach of the insurance code, it quoted the California case of *Fletcher v. Western National Life Ins. Co.*,<sup>20</sup> saying "An insurer owes its insured an implied-in-law duty of good faith and fair dealing that it will do nothing to deprive the insured of the benefits of the policy."<sup>21</sup> Of prime importance in the case was the court's holding that it was unnecessary to prove actual malice for punitive damages allowing a standard of implied malice to invoke the damage.<sup>22</sup> This was deemed alarming to those who felt the evidence in *Goddard* only showed error and no malice on the part of the insurer.<sup>23</sup>

*Harris v. American Gen. Life Ins. Co.*,<sup>24</sup> allowed a first-party benefit claim for punitive damages for bad faith even though the jury ultimately found no benefit due the claimant so that the punitive damage claim was not supported by any compensatory damages. The court's holding virtually eliminated the actual damage requirement and made a claim possible where the insurer's handling of the claim was offensive even though it ultimately did not owe the benefit it denied.

#### **Development of Third-Party Bad Faith**

In 1979, the California Supreme Court delivered the blockbuster decision of *Royal Globe Ins. Co.*

*v. Superior Court of Butte County*,<sup>25</sup> when it overturned a long line of precedent by holding that a third-party claimant could sue an insurance company for violating the California "Unfair Trade Practices Act (UTPA)".<sup>26</sup> The California UTPA was virtually identical to Montana's which made it predictable that Montana would follow suit as it did in *Klaundt v. Flink*.<sup>27</sup> The Montana Supreme Court held that a third-party claimant in Montana could have a direct private civil right of action against an insurer for breach of §33-18-201 of the UTPA. The court said the UTPA was meant for the benefit of third-party claimants as well as first-party insureds, and held that the statute's preliminary requirement that the insurer's conduct be shown to occur "with such frequency as to indicate a general business practice" could be proven by evidence of multiple violations of the code during handling of a single claim.<sup>28</sup>

However, the most striking feature of the *Klaundt* decision was its holding that the third-party action against the insurer for bad faith "may be filed and tried before, concurrent with, or after liability has been determined."<sup>29</sup> Even Chief Justice Morrison, recognized for his consumer advocacy, warned against that holding. Joining of the underlying action with the bad faith tort was viewed as creating insurmountable conflict for the insurer.<sup>30</sup>

Not surprisingly, after three years of experimentation linking the underlying action with the bad faith action, the court overturned that as-

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pect of *Klaude* in the case of *Fode v. Farmers Ins. Exch.*<sup>31</sup> There, the court held that bad faith proceedings alleging the insurer's violation of the insurance code must be suspended until the underlying claims have been determined by settlement or judgment. The court admitted that *Klaude's* procedure of allowing the actions to be joined was a mistake that placed insurers in conflict and causing them prejudice.

### Good Faith and Fair Dealing by the Fiduciary

In 1984, the court revisited *Jessen* when it decided the case of *Gibson v. Western Fire Ins. Co.*,<sup>32</sup> a first-party excess-coverage case. While the court applied the original *Jessen* factors in upholding the excess-coverage verdict against the insurer, its decision reflected the intervening evolution in law insofar as the court treated the failure to settle as a breach of an implied obligation of good faith and fair dealing by a fiduciary bound by a duty of highest good faith. The court said:

The duty to accept a reasonable offer within policy coverage limits arises from an implied covenant of good faith and fair dealing that neither party will do anything which will injure the right of the other to receive the benefits of the agreement. One of the usual benefits of a liability insurance policy is the settlement of claims without litigation, or at least without trial if the cause is litigated. The implied obligation of good faith and fair dealing requires the insurer to settle in an appropriate case, al-

though the express terms of the policy do not impose the duty. In determining whether to settle, the insurer must give the insured's interest as much consideration as it gives its own interest.<sup>33</sup>

The *Gibson* case was based entirely on judicially created princi-

UTPA and to create protections for the insurers. The resulting bill, was codified as follows:

### 33-18-242. Independent cause of action—burden of proof.

(1) An insured or a third-party claimant has an independent cause of action against an insurer for actual damages caused by the insurer's violation of subsection (1), (4), (5), (6), (9), or (13) of 33-18-201.

(2) In an action under this section,

a plaintiff is not required to prove that the violations were of such frequency as to indicate a general business practice.

(3) An insured who has suffered damages as a result of the handling of an insurance claim may bring an action against the insurer for breach of the insurance contract, for fraud, or pursuant to this section, but not under any other theory or cause of action. An insured may not bring an action for bad faith in connection with the handling of an insurance claim.

(4) In an action under this section, the court or jury may award such damages as were proximately caused by the violation of subsection (1), (4), (5), (6), (9), or (13) of 33-18-201. Exemplary damages may also be assessed in accordance with 27-1-221.

(5) An insurer may not be held liable under this section if the insurer had a reasonable basis in law or in fact for contesting the claim or the amount of the claim, whichever is in issue.

### The implied obligation of good faith and fair dealing requires the insurer to settle in an appropriate case, although the express terms of the policy do not impose the duty.

ples of bad faith and not on the UTPA (§33-18-201). The court in *Gibson* said that an insurer which "intentionally conceals material facts within its knowledge and not known by its insured may be found in bad faith" so long as the facts concealed are material to the subject of the trust or duty of the fiduciary.<sup>34</sup> The court reasoned that the fiduciary is bound to the highest good faith in the subject of its trust. Note that the UTPA does not treat the insurer's concealing of material facts from the insured as a basis for tortious bad faith. Hence, *Gibson* presents an example of conduct that is bad faith at common law but not under the statutes.

### Legislative Restriction of Bad Faith

The 1987 Montana Legislature was probably the most significant in the state's history in terms of "tort reform." Fear of the tort of bad faith and punitive damages was an obsession with insurance companies and their allied banks. That year, the insurance lobby secured legislative restriction of insurance bad faith<sup>35</sup> and punitive damages<sup>36</sup>. The intent was to limit the bad faith remedy to certain conduct prohibited by the

(6) (a) An insured may file an action under this section, together with any other cause of action the insured has against the insurer. Actions may be bifurcated for trial where justice so requires.

(b) A third-party claimant may not file an action under this section until after the underlying claim has been settled or a

judgment entered in favor of the claimant on the underlying claim.

(7) The period prescribed for commencement of an action under this section is:

(a) for an insured, within 2 years from the date of the violation of 33-18-201; and

(b) for a third-party claimant, within 1 year from the date of the settlement of or the entry of judgment on the underlying claim.

(8) As used in this section, an insurer includes a person, firm, or corporation utilizing self-insurance to pay claims made against them.

This statutory restriction was viewed as draconian and bitterly resisted by the Montana Trial Lawyers Association. It purports to limit bad faith actions to certain specified conduct in the handling of claims. It provides the insurer an affirmative defense if it "had a reasonable basis in law or in fact for contesting" a claim. It purports to limit both first-party and third-party claims, and it shortens statutes of limitations in favor of the insurers. Perhaps the most insidious aspect of the statute is its failure to include subsection (7) of the Unfair Claims Settlement Practices Act, 33-18-201 as a basis for the independent cause of action.

That subsection declares it to be an unfair claims practice to:

compel insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds;

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**Legislative "reform" of punitive damages was also key to restricting bad faith, since punitive damages are an essential part of the remedy of insurance company abuse of consumers and claimants.**

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That practice may be the most frequent form of claims settlement abuse by insurers and can cause the innocent third party to incur unrecoverable actual damages in the form of attorney fees to obtain that which should have been theirs in the first place.

Nevertheless, the statute also codified a private right of action for third-party bad faith claims for breach of the UTPA. This was a significant outcome in light of the fact that California's landmark *Royal Globe* case, which originally created the right, was later overturned by *Moradi-Shalal v. Fireman's Fund Ins. Companies*<sup>37</sup> in a trend that ended private rights of action for violation of UTPA-type statutes in other states. In the wake of *Moradi-Shalal*, one of the principle insurance scholars in the United States wrote, "Although there are still remnants of the private cause of action in a few other states, it now appears to be a development whose time has passed."<sup>38</sup> The fact is the 1987 Montana legislation granted statutory recognition to the following:

1. Existence of a cause of action for bad faith independent of the insurance

contract;

2. Six categories of conduct of insurers which entitle the third-party claimant to the action;

3. Relief from the burden of proving that the conduct occurs with such frequency as to indicate a general business practice;

4. Punitive damages for bad faith; and

5. Extension of the cause of action to self-insurers.

**The "Reform" of Punitive Damages**

Legislative "reform" of punitive damages was also key to restricting bad faith, since punitive damages are an essential part of the remedy of insurance company abuse of consumers and claimants. Amid fierce lobbying, the legislature statutorily purported to block punitive damages for breach of contract<sup>39</sup> (§27-1-220); required actual as opposed to implied malice as a standard for punitive damages (§27-1-221); required a separate hearing on the amount of punitive damages; stepped-up the burden of proving punitive damages to "clear and convincing" evidence; and enacted other procedural hurdles. The only bright spot was that the legislature adopted the standard for actual malice from *Owens v. Parker Drilling Co.*,<sup>40</sup> which is more consumer friendly than the old statutory standard of "malicious, fraudulent or oppressive."

**The Survival of Common Law Bad Faith**

Enactment of §33-18-242, restricting the bad faith cause of action under the UTPA, left questions about the surviving state of common law bad faith tort as applied to insurance. Plaintiffs' counsel wondered whether any form of common law insurance bad faith survived the

1987 legislature? Was there such a thing as bad faith conduct outside the handling of the claims? The picture looked grim, and §33-18-242 was not the only blow the tort of bad faith, as applied to insurance, would suffer. In 1990, in the case of *Story v. City of Bozeman*,<sup>41</sup> the Montana Supreme Court placed a severe restriction on claims for bad faith breach of contract which necessarily applied to insurance policies be-

cause they are contracts. *Story* involved a construction contract between a contractor and the City of

Bozeman. The pertinent cause of action was the contractor's appendant claim for bad faith tort based on implied malice in the city's breach of the construction contract. The court held that there was no cause of action for bad faith in the breach of a contract, even if intentional or malicious. The court reversed the development of the tort of bad faith as applied to contract breaches when it reasoned that every contract involves a covenant of good faith and fair dealing, so that breach of that covenant merely gives rise to a claim for breach of contract and not a claim in tort.

However, the court recognized an exception to its prohibition against bad faith tort in contract claims for those situations involving "special circumstances," in which a special relationship existed between the contracting parties that would allow for a claim of bad faith tort. The court specified five factors for identifying such a special relationship:

(1) the contract must be such that the parties are in inherently unequal bargaining positions; [and] (2) the motivation for entering the

contract must be a non-profit motivation, i.e., to secure peace of mind, security, future protection; [and] (3) ordinary contract damages are not adequate because (a) they do not require the party in the superior position to account for its actions, and (b) they do not make the inferior party

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**There the court said that a third-party claimant could bring an action against a claims adjuster as well as an insurer under §33-18-201 and §33-18-242.**

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"whole"; [and] (4) one party is especially vulnerable because of the type of harm it may suffer and of necessity places trust in the other party to perform; and (5) the other party is aware of this vulnerability.<sup>42</sup>

The immediate question was whether the relationship between insured and insurer was a "special relationship." In *Stephens v. Safeco Ins. Co. of America*,<sup>43</sup> the court applied the five *Story* factors to the contract between an insured and insurer and found it was. *Stephens* predated the UTPA's restrictions on bad faith claims, though it was decided after enactment of the UTPA. Nevertheless, it is important that, in *Stephens*, the court recognized the existence of common law bad faith tort outside the context of the Unfair Trade Settlement Practices Act:

[I]nsurance companies have a duty to act in good faith with their insureds, and this duty exists independent of the insurance contract and independent of statute. If this duty is breached the cause of action of the in-

sured against the insurer sounds in tort.<sup>44</sup>

In *O'Fallon v. Farmers Ins. Exch.*,<sup>45</sup> the court held that an insured could bring a common law action if the Unfair Trade Settlement Practices Act did not apply. There the court said that a third-party claimant could bring an action against a claims adjuster as well as an insurer under §33-18-201 and §33-18-242. The court said *Klandt's* authorization of a direct action against a "person" under §33-18-201 was not in conflict

with §33-18-242, which provides for the statutory cause of action against insurers but did not "otherwise limit previously created common law causes of action." However, a claimant pressing an action against an adjuster under §33-18-201 must prove that the conduct occurs "with such frequency as to indicate a general business practice" under that statute, while an action against an insurer under §33-18-242 is relieved of that burden of proof.

### **The Recent Life of Bad Faith in Insurance**

In 1998, the court identified a whole area of insurer conduct not governed by the UTPA and hence not subject to the bad faith restrictions of §33-18-242. In *Thomas v. Northwestern National Insurance Company*,<sup>46</sup> the Thomases sued their insurer, Northwestern National, for negligence, bad faith, and breach of fiduciary duty after the carrier refused to defend them on a pollution claim arising from an oil spill caused by their plumbing business. The Thomases contended that Northwestern had a duty to warn them, upon annual renewal of their commercial general insurance policy, that the company had inserted a more

restrictive "Total Pollution Exclusion" resulting in a lack of coverage for the spill. It followed that the Thomases claimed the insurer breached its fiduciary obligation and acted in bad faith in not warning them of the detrimental change in the policy. The case is significant in two areas: First, collateral to the bad faith issues, the court found that Northwestern did have a duty to warn of the more restrictive pollution exclusion and established that insurers have the burden of proving that they provided adequate notice of policy changes to their insureds.

Second, Northwestern successfully persuaded the lower court that Montana's UTPA, specifically §33-18-242(3) precluded the Thomases' common law claims for negligence, bad faith, and breach of fiduciary duty. However, the Montana Supreme Court disagreed that these were claims arising out of the "handling of an insurance claim" so as to bring them within the restrictions of the statute. The court noted that the obvious intent of the UTPA was to protect insureds from unfair treatment by insurers in the handling of claims. The Thomases' claims focused on Northwestern's conduct during the renewal of the policy prior to the handling of the claims.

The court found that the legislature did not intend the UTPA to be the exclusive remedy for insureds bringing litigation against their insurers and noted the language of §33-18-242(6)(a) that "an insured may file an action under this section, together with any other cause of action the insured has against the insurer." [author's emphasis] However, Northwestern also contended that *Story* blocked any collateral tort claim since this was a claim for

breach of the contractual insurance policy promises. The court applied the five element analysis of *Story* and confirmed that the relationship between the insureds, Thomases, and insurer, Northwestern, was a "special relationship" which could support a bad faith action. Furthermore, the court concluded that the Thomases' claims of bad faith and breach of fiduciary duty survived

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**The court recently expanded rights of third-party insureds under the UTPA in resolving the conflict that occurs when the claimant cannot sign a full and final release and the insurer refuses to tender minimum limits without such signing.**

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§33-18-242, because the common law, in that situation, was not in conflict with §33-18-242. The court reiterated what it said in *O'Fallon*: Insurers have a duty to act in good faith, and that duty still exists independent of the insurance contract and statute.

The court recently expanded rights of third-party insureds under the UTPA in resolving the conflict that occurs when the claimant cannot sign a full and final release and the insurer refuses to tender minimum limits without such signing. In *Watters v. Guaranty National Ins. Co.*,<sup>47</sup> the court said:

[W]e hold that where an insured's liability for damages caused to a third party in an auto accident is reasonably clear, and those damages undisputedly exceed the mandatory limits set forth under §61-6-103, MCA, it is an unfair trade practice *per se* under §33-18-201, MCA, for an insurer to condition the payment of the owed mandatory minimum policy limits on the third party's agreement to provide a full and final re-

lease of all liability in favor of an insured.

The court also made the logical holding that an insurer which, in a clear-liability excess-damages case, pays minimum limits without obtaining a full and final release, is not *per se* acting in bad faith.

Guaranty National had taken the position that, under §33-18-201(6), it had a duty "to effectuate prompt, fair and equitable settlements of claims" [author's emphasis] and that, under *Juedeman v. National Farmers*

*Union*,<sup>48</sup> without an agreement for release, there could be no settlement. Guaranty claimed it conditioned its tender of minimum limits on signing of the release, because it feared a bad faith action by its insured if it did not. The court noted that the policy provided no promise by the insurer that it would obtain a release and that a minimum limits insured could have no such expectation in the circumstances. Most importantly, the court said it would not second guess the legislature's provision in UTPA §33-18-242(3) that "An insured may not bring an action for bad faith in connection with the handling of an insurance claim." Consequently, the court held that the insurer may no longer impose the full and final release as a condition to settlement in minimum limits cases.

This has two imports: First, it will be easier to convince carriers to promptly pay minimum limits to third-party claimants. Second, as pointed out by Gary Zadick, who even before this case counseled carriers to pay such limits without demanding a release, claimant's counsel will lose the "setup" for bad faith which occurs when carriers condition payment of minimum limits in



clear-liability bad-damages cases on signing of full and final releases. "Setup" aside, the holding is a good sound step in effectuating prompt and fair settlements.

The biggest recent news from the bad faith front is the court's holding in *Brewington v. Employers Fire Ins. Co.*,<sup>49</sup> that the UTPA does not preempt common law claims for third-party bad faith. On appeal to the Montana Supreme Court, Brewington won a workers' compensation decision granting him permanent total disability benefits and ordering Employers Fire Insurance and Commercial Union to pay his benefits and attorney fees. Brewington later sued defendants for breach of the duty of good faith and fair dealing claiming that they refused to pay the attorney fees as ordered and engaged in a course of continuous tortious conduct. The district court dismissed Brewington's complaint on the ground that the statute of limitations governing third-party claims under the UTPA barred the bad faith claims brought by his personal representative. However, the Supreme Court found the UTPA did not apply. The court noted that subsection (1) granted an *insured* or a *third-party claimant* an independent cause of action against an insurer for breach of the UTPA. However, the court pointed out that subsection (3) limiting actions against the insurer to breach of contract, fraud, or the specified conduct of the UTPA and forbidding "any other theory or cause of action" applied only to an *insured*. That subsection did not mention *third-party claimants*. Consequently, the court held that §33-18-242 does not preclude a third-party claimant from bringing an action for common law bad faith.

On the basis of that holding, the court then found that the UTPA's statute of limitations of one

year from settlement or entry of judgment did not apply. Instead, the court held that the statute for third-party common law bad faith claims is the three years provided under §27-2-204. Justice Gray concurred that subsection (3) of §33-18-242 did not apply to third-party claimants but appeared to do so unhappily and all but told the legislature to amend. Hence, this decision which is music to those representing

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**The tort of insurance bad faith and the attendant potential for punitive damages are potent weapons in the fight to make insurance companies honor their promises and duties to claimants and insureds.**

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claimants against insurers may provoke a legislative response. That is a good reminder that the law of insurance bad faith is made in part by those legislators who win their campaigns.

*Brewington* aside, counsel should note the potential statute of limitations pitfall in §33-1-242(7). The limitation under subsection (7) for third-party claimants is one year from the date the underlying claim is brought to conclusion, but the statute for first-party claims is two years from the alleged occurrence of the bad faith. Hence, counsel litigating a first-party claim like UIM may forget the running of the statute thinking it is preserved until resolution of the underlying claim. As Pat Sheehy says, "It's a short porch."

Finally, the court has just held in *Safeco Ins. Co. v. Montana 8<sup>th</sup> Judicial Dist. Court*,<sup>50</sup> that a declaratory judgment action brought to enforce advance payment of medical expense pursuant to *Ridley v. Guaranty Nat'l Ins. Co.*,<sup>51</sup> is not barred by the UTPA, §33-18-242(6)(b) and may be brought before the underlying claim has been disposed of by settlement or judgment. While this decision is premised on Medical Pay coverage, it means that plaintiff's counsel can

use declaratory judgment to enforce or clarify rights under any coverage before the underlying claim is settled or adjudicated so long as the action doesn't seek bad faith damages for violation of the UTPA.

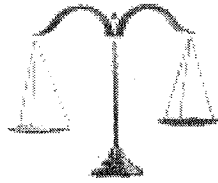
### Conclusion

Insurance bad faith tort is alive in Montana. We are in the unusual situation of having codified the private right of action for third-party claimants under the UTPA while that right has disappeared or never existed in most other states. The third-party common law action for bad faith

has been affirmed in *Brewington*, as has the common law action for first-party bad faith for insurer misconduct prior to handling of the claim. First-party claims for conduct during handling of the claim are codified with a comprehensive set of prohibited insurer conduct, allowance of punitive damages and relief from the burden of proving such frequency of the insurer's conduct as to be a general business practice. First and third-party claimants may, during the underlying litigation, in spite of any prohibition of the UTPA, seek declaratory judgments to enforce coverage rights. The recent *Thomas*, *Brewington*, and *Watters* decisions indicate that the Montana Supreme Court will carefully scrutinize the UTPA and expansively interpret it to allow insurance consumers and third-party claimants the remedies necessary to promote prompt, fair, and equitable settlements.

The tort of insurance bad faith and the attendant potential for punitive damages are potent weapons in the fight to make insurance companies honor their promises and duties to claimants and insureds. Consequently, one can expect that bad faith tort will always be under attack, so vigilance by plaintiffs' counsel in

# Montana Pattern Instructions



The Montana Supreme Court Commission on Civil Jury Instructions (MPI) is committed to developing and maintaining the best possible set of pattern instructions. MPI welcomes suggestions from attorneys, especially in developing areas of the law or in areas where there are presently no published pattern instructions.

**If you have suggestions,  
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court and on the campaign trail will be necessary to keep the weapon sharp.

1. MCA §33-18-201.
2. 210 F.Supp. 317 (D. Mont. 1962), *aff'd sub nom.*, *National Farmers Union Property & Cas. Co. v. O'Daniel*, 329 F.2d 60 (9<sup>th</sup> Cir. 1964).
3. *Id.* at 326.
4. *Id.* at 326-27.
5. 257 F.Supp. 4 (D. Mont. 1966).
6. 454 P.2d 76 (Mont. 1969).
7. 505 P.2d 423 (Mont. 1973).
8. 374 P.2d 96 (Mont. 1962).
9. 423 P.2d 598 (Mont. 1967).
10. *Id.* at 600.
11. Steven J. Harman, *An Insurer's Liability for the Tort of Bad Faith*, 42 Mont. L. Rev. 67 (Winter 1981).
12. Ch. 286, L. 1959.
13. 643 P.2d 198 (Mont. 1982).
14. *Id.* at 203.
15. 655 P.2d 970 (Mont. 1982).
16. *Id.* at 977.
17. Ch. 320, L. 1977.
18. 593 P.2d 1040 (Mont. 1979).
19. *Id.* at 1047.
20. 10 Cal. App.3d 376, 89 Cal. Rptr. 78 (1970).
21. *Goddard*, 593 P.2d at 1047.
22. *Id.* at 1048-49.
23. Harman, *supra* n.11.
24. 658 P.2d 1089 (Mont. 1983).
25. 592 P.2d 329 (Cal. 1979).
26. Cal. Ins. Code §790.03(h).
27. 658 P.2d 1065 (Mont. 1983).
28. *Id.* at 1068.
29. *Id.* at 1067.
30. Gary L. Graham & Bradley J. Luck, *The Continuing Development of the Tort of Bad Faith in Montana*, 45 Mont. L. Rev. 43 (Winter 1984).
31. 719 P.2d 414 (Mont. 1986).
32. 682 P.2d 725 (Mont. 1984).
33. *Id.* at 730.
34. *Id.* at 741.
35. Ch. 278, L. 1987.
36. Ch. 627, L. 1987.
37. 758 P.2d 58 (Cal. 1988).
38. Kenneth Abraham, *INSURANCE LAW AND REGULATION*, 621 (2d ed. 1995).
39. Ch. 627, L. 1987.
40. 676 P.2d 162 (Mont. 1984).
41. 791 P.2d 767 (Mont. 1990).
42. *Id.* at 776.
43. 852 P.2d 565 (Mont. 1993).
44. *Id.* at 567.
45. 859 P.2d 1008 (Mont. 1993).
46. 973 P.2d 804 (Mont. 1998).
47. 2000 MT 150.
48. 253 Mont. 278, 883 P.2d 191 (1992).
49. 992 P.2d 237 (Mont. 1999).
50. 2000 MT 153.
51. 286 Mont. 325, 951 P.2d 987 (1997).